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Private Law: Security Devices

Thomas A. Harrell

SECURITY DEVICES

*Thomas A. Harrell**

SURETYSHIP

The extent to which the Deficiency Judgment Act[1] applies to a surety has given the courts difficulty throughout the years. The matter was again considered by two of the circuits with somewhat conflicting results. In *Ford Motor Credit Company v. Soileau*,[2] defendant executed a note as co-maker for the accommodation of his son who had borrowed money from plaintiff to purchase an automobile. The son also secured the note with a chattel mortgage upon the vehicle. Upon default, the plaintiff had the automobile sold by executory process with benefit of appraisal and then sued defendant for the deficiency. Defendant argued that he had been released from liability because he had not been made a party to the executory proceedings, and that therefore as to him the sale had in substance been made without appraisal. The lower court agreed with defendant and dismissed the suit, but the Third Circuit reversed, holding that the Deficiency Judgment Act was designed to protect only the mortgage debtor who owned an interest in the property which was sold. The court noted that there is no procedure by which a person who is not the owner of the property can be made a party to executory proceedings. The opinion appears to be correct. In theory executory process is the execution of a judgment which has been confessed by the debtor, the effect of which is limited to property upon which he has given a mortgage or other security. Thus, no one is before the court except the judgment debtor. The surety can no more be made a "party" to such proceedings than he could if the creditor had secured a judgment against the debtor and was executing upon his property by writ of *fieri facias*.

In *Murdock Acceptance Corporation v. S.&H. Distributing Company*,[3] an Arkansas corporation sold three hundred vending machines to a

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* Professor of Law, Louisiana State University.

1. "If a mortgagee . . . takes advantage of a waiver of appraisement of his property . . . by a debtor, and the proceeds of the judicial sale thereof are insufficient to satisfy the debt for which the property was sold, the debt nevertheless shall stand fully satisfied . . . . The mortgagee . . . shall not have a right thereafter to proceed against the debtor . . . ." LA. R.S. 13:4106 (1950), *as amended by* La. Acts 1960, No. 32, § 1. "R.S. 13:4106 declares a public policy and the provisions thereof can not . . . be waived . . . ." LA. R.S. 13:4107 (1950).

2. 323 So. 2d 221 (La. App. 3d Cir. 1975).

3. 331 So. 2d 870 (La. App. 2d Cir.), *cert. denied*, 334 So. 2d 435 (La. 1976).

Texas corporation. Defendant, a Louisiana corporation located in Shreveport, apparently acted as a broker for the seller and was instrumental in locating the purchaser of the machines. The sales agreement and a guarantee by defendant to the seller for the purchase price were executed in Shreveport. After delivery which was apparently effected from Arkansas to Texas the purchaser complained of numerous defects in the machines and returned them to the seller's assignee who sold them at private sale and applied the proceeds to the amount owed by the purchaser. The seller had assigned its rights under the contract to plaintiff, a Tennessee corporation, who brought suit against the guarantor for the balance remaining on the account.

The lower court held that the surety had been released by a failure of the consideration for the contract between the purchaser and seller and that, in any event, Louisiana law would preclude a deficiency judgment against the surety since there had been no judicial appraisal of the property before its sale. Plaintiff contended on appeal that the law of either Texas or Arkansas was applicable and that, under the law of either state, plaintiff was entitled to assert the deficiency against the purchaser and the guarantor.

In affirming the judgment, the Second Circuit declared that Louisiana has a strong public policy protecting debtors against deficiency judgments citing the Deficiency Judgment Act as an expression of that policy. It then noted that no effective choice of law had been made by the parties and that consequently the court must look to the interest of the various states having contact with the transaction to determine what law should be applied. Finding that neither Arkansas nor Texas had an interest in whether a deficiency judgement was allowed to a Tennessee creditor against a Louisiana debtor, the court concluded that in view of Louisiana's strong public policy the claim against the surety should not be allowed.

The *Murdock* case is admittedly a close one. Had the court chosen to rest its decision upon the fact that there were sufficient contacts with Louisiana to make the contracts subject to its law, it would have been of little significance. However, the basis apparently chosen by the court for its decision was simply that Louisiana's public policy precludes a deficiency judgment against a surety domiciled in this state even though the contract guaranteed was to be performed in another state and the principal debtor had not been released under the law of that state. It is doubtful that any other state has a procedure which would satisfy the requirements of a sale with judicial appraisal as contemplated by the Deficiency Judgment Act. To refuse to hold a surety for his principal debtor's liability solely because the surety is domiciled in Louisiana when the transactions are to be performed in another state can only serve to isolate the Louisiana business community further from the mainstream of American commerce. The court may not have intended its opinion to have the broad effect here suggested; nonetheless, a Louisiana contractor bidding on a job in another state might well encounter difficulty with a proposal to guarantee his performance by the bond of a Louisiana surety.

On balance, the Third Circuit's approach to the Deficiency Judgment Act in *Soileau* is more satisfactory. The act does not and cannot logically apply to sureties. A surety cannot grant to the creditor the right to sell the principal debtor's property without appraisal, nor object to such a sale if the creditor and principal debtor so agree. The liability of a surety is an accessory one; his responsibility should be dependent upon whether the actions of the creditor have effected a discharge of the primary obligation which is guaranteed. When an action by the creditor results in the discharge of the principal debt it should release the surety. On the other hand, if the debtor has preserved his rights against the creditor and has not prejudiced the surety by the release of any of his rights of subrogation, there is no reason why the surety should not also perform his obligation. The approach in *Soileau* which limits the effect of the Deficiency Judgment Act to the debtor who waives the right of appraisal and then considers the effect which his release has upon the liability of other parties to the transaction appears to be the most desirable.

In *Gauthier v. Scott*,[4] plaintiff and defendant were the sole shareholders of a corporation which borrowed money from the American Bank and Trust Co. The shareholders had given the bank a "continuing guaranty" which provided that they as guarantors obligated themselves in solido for the payment of the corporation's debt to the bank. The corporation defaulted on its obligation. Plaintiff paid the debt and then sued the defendant for contribution of one-half of the payment. The defendant answered relying upon the provisions of Civil Code article 3058 which provides that a surety who has satisfied the debt may recover from his co-sureties only if he has paid after a law suit has been instituted.[5] The plaintiff (apparently in response to the defense) amended his petition and alleged that the petitioner

4. 327 So. 2d 702 (La. App. 1st Cir.), *cert. denied*, 330 So. 2d 314 (La. 1976).

5. "When several persons have been sureties for the same debtor and the same debt, the surety who has satisfied the debt, has his remedy against the other sureties in proportion to the share of each; but this remedy takes place only, when such person has paid in consequence of a law suit instituted against him." LA. CIV. CODE art. 3058.

and the defendant were bound in solido with the creditor. He then argued that the provisions of article 3058 are not applicable to solidary sureties. The court of appeal essentially agreed with the plaintiff finding that under the provisions of Civil Code article 3045 when a surety binds himself in solido with the debtor the relationship is regulated by the principles established for debtors in solido not those of suretyship.[6] Unfortunately for the plaintiff, it then held that plaintiff and defendant must be considered bound solidarily with the corporation and in the absence of proof that the corporation was insolvent the plaintiff could recover no more than one-third of the debt from the defendant. Civil Code article 2104 provides that when one of the debtors in solido pays the whole debt he can claim from the others "no more than the portion of each" unless one of them is insolvent, in which event the loss occasioned by his insolvency must be equally shared by all of the other co-debtors.

The court made no mention in its opinion of Civil Code article 2106 which provides that when an affair contracted in solido concerns only one of the debtors, he is considered as a principal and the other obligors "are considered only as his securities," thus implying that the articles on suretyship govern the relationship between such parties. Furthermore, the note was endorsed and delivered to the plaintiff when he paid it. The courts have previously held that article 3058 is not applicable to a surety who pays the principal debt and obtains a conventional subrogation of the obligation from the creditor so that he may recover a pro rata part of the debt from the co-surety.[7] This line of cases was apparently not called to the court's attention and it thus did not have to deal with the problem of correlating its interpretation of article 3045 with the principles relied upon in them. Extensive comment was made in last year's symposium[8] on the difficulties which will be occasioned in interpreting article 3045 as the court did in the case under consideration and of the problems which are bound to arise in attempting to apply the articles on solidarity to obligors who are in substance sureties for a debt. To permit a surety to recover from his co-surety only one-third of the debt which he has paid, thus leaving him to bear two-thirds

6. "The obligation of the surety towards the creditor is to pay him in case the debtor should not himself satisfy the debt; and the property of such debtor is to be previously discussed or seized, unless the security should have renounced the plea of discussion, or should be bound *in solido* jointly with the debtor, in which case the effects of his engagement are to be regulated by the same principles which have been established for debtors *in solido*." *Id.* art. 3045.

7. Phillips v. Pedarre, 156 La. 509, 100 So. 699 (1924); Fox v. Corry, 149 La. 445, 89 So. 410 (1921).

8. *The Work of the Louisiana Appellate Courts for the 1974-1975 Term—Security Devices*, 36 LA. L. REV. 437 (1976).

of the obligation which they have jointly undertaken as was done in the present case is an example of the erroneous results to which such an interpretation will lead.

MORTGAGES

In *Quality Finance Company v. Bourque*,[9] the supreme court reversed a decision by the First Circuit and reaffirmed what the author believes has always been the law of Louisiana. The facts were as follows: Quality Finance Company held a second mortgage on property on which several other persons held inferior privileges and mortgages. The owners defaulted on their obligation to Quality which instituted executory process on its mortgage. To avoid bankruptcy and to eliminate the cost of the executory proceedings the owners transferred the property to Quality in consideration of the cancellation of their debt and of the assumption by Quality of the obligation secured by the first mortgage on the property. The total owed on the two obligations was $29,774. The property had been appraised in the executory proceedings at $29,000. Apparently in anticipation of the transfer to it, Quality located a buyer who agreed to pay $29,000 for the property. Before taking title from Quality, the prospective buyer discovered that the inferior incumbrances had not been cancelled and refused to conclude the sale. Quality then instituted the suit in question as a mandamus action against the clerk to compel concellation of the incumbrances, joining the holders of the uncancelled but inferior security as parties. The trial court held that since the property had been appraised for less than the amount of incumbrances cancelled or assumed by Quality no prejudice had been suffered by the holders of the inferior security by the transfer to Quality and ordered their security cancelled. The court of appeal affirmed the judgment and the supreme court issued writs. The supreme court, while noting that the appraisal of the property for $29,000 did not prove that it might not bring more at a sheriff's sale, held that whether the inferior creditors had suffered prejudice was immaterial. They owned real rights in the property by virtue of their mortgages and privileges which could be extinguished only in a manner prescribed by law and absent either a judicial sale or the consent of the holders of the security their incumbrances remained against the property.

THE PRIVATE WORKS ACT

In *Bowles and Edens Company v. H & H Sewer Systems, Inc.*,[10] the

9. 315 So. 2d 656 (La. 1975).
10. 324 So. 2d 528 (La. App. 1st Cir. 1975).

First Circuit Court of Appeal again wrestled with the question of whether a surety bond given in apparent compliance with the Private Works Act is a "statutory" or a "conventional" one. The problem is caused by the well established rule of construction that where a "statutory" bond is given by a surety its terms will be construed to conform to the requirement of a statute under which it is given so that whatever is in the bond that is not required by the statute will be read out of it and whatever is not expressed in the bond which is required by the statute will be included in it. The problem results from the fact that while the terms of a bond given under the Private Works Act are prescribed by the act such a bond is "conventional" in the sense that the owner of the property who contracts for its improvement is not obligated to require his contractor to give a bond although his failure to do so will subject him to liability to the laborers, suppliers of material, or subcontractors on the job. Furthermore, owners frequently require a contractor to give a surety bond for their protection but with no evident intention of having it conform to the act.

The court in the case under consideration concluded that a bond given pursuant to the Private Works Act was a "statutory one" which would call into play the rule of construction in question.

Some of the difficulty which the courts have encountered lies in the fact that they have tended to view the rule as a matter of imperative law arising out of the nature of the bond rather than as a judicially developed rule of contractual construction, albeit one founded on matters of public policy. The early cases explained the rule on the grounds that where the evident intention of the principal was to extract from the surety a bond the terms of which were prescribed by law any deviation from those terms would be so contrary to the obvious intention of the parties to the contract that they should be ignored and the bond read as though it had been properly written. The justification for the rule thus rests upon the assumption that a surety who is paid to give bond to comply with the requirement of law, should not be permitted thereafter to deny that his undertaking is contrary to that which the law required and which he is presumed to know. This has been obscured by characterizing the rule as being dependent upon whether the bond is "statutory" or "conventional." All bonds are conventional in that they are the voluntary undertaking of the surety. The application of the rule should depend not upon whether the owner was required by law to give a bond but upon whether the surety intended to give a bond which complies with the particular requirements of a statute. A bond given by a surety pursuant to the Private Works Act is such a bond and if the rule has any validity at all, it should be so applied. It is true that it may be necessary in the first instance to determine whether the surety did intend to undertake the responsibility required by the statute rather than to afford the owner some lesser measure of security. But when it is concluded that such was the case there is no less reason to apply the rule of construction to such a bond than to any other. The conclusion by the court of appeal is eminently correct and hopefully, the case will help to set the matter at rest.